



**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

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WENDY L. WATANABE
AUDITOR-CONTROLLER

June 14, 2013

TO: Supervisor Mark Ridley-Thomas, Chairman
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: Wendy L. Watanabe
Auditor-Controller

A handwritten signature in blue ink, reading "Wendy L. Watanabe", is written over the printed name and title.

SUBJECT: **OPTIONS – A CHILD CARE AND HUMAN SERVICES AGENCY – A
DEPARTMENT OF PUBLIC SOCIAL SERVICES CALWORKS STAGE
ONE CHILD CARE SERVICES PROGRAM PROVIDER – CONTRACT
COMPLIANCE REVIEW**

At the request of the Department of Public Social Services (DPSS), we completed a review of Options – A Child Care and Human Services Agency (Options or Agency), which covered a sample of transactions from Fiscal Year (FY) 2011-12. DPSS contracts with Options, a non-profit organization, to operate the CalWORKs Stage One Child Care Services (Stage One) Program, which helps families access immediate, quality, and affordable child care as they move through their Welfare-to-Work activities.

The purpose of our review was to determine whether Options appropriately accounted for and spent Stage One Program funds to provide the services outlined in their County contract. We also evaluated the Agency's accounting records, internal controls, and compliance with their contract and other applicable guidelines.

DPSS paid Options approximately \$4.8 million on a fixed-fee basis during FY 2011-12. Options provided services to residents of the First, Fourth, and Fifth Supervisorial Districts.

Results of Review

Options provided services to individuals who met the Stage One Program eligibility requirements and the services provided were in compliance with the County contract.

In addition, Options' staff working on the County contract had the required qualifications. However, the Agency recorded \$40,178 in shared program expenditures to the Stage One Program using an allocation method that does not comply with the Office of Management and Budget's Circular A-122 – Cost Principles for Non-Profit Organizations. The Agency inappropriately used estimates to allocate the shared program expenditures.

Options' attached response indicates they disagree with our finding and that cost allocation principles did not apply since their Stage One contract with the County is a fixed-fee contract. According to County Counsel, cost allocation principles still apply and Options is required to comply with the Office of Management and Budget's Circular A-122 – Cost Principles for Non-Profit Organizations. However, County Counsel agrees that their fixed-fee contract does not allow DPSS to collect the over-allocated expenditures.

DPSS amended their Stage One contracts effective FY 2012-13 so the County can recover costs that are inappropriately charged to the program. DPSS also amended the Stage One contracts to require agencies to return or reinvest unspent revenues.

Details of our review, along with a recommendation for corrective action, is attached.

Review of Report

We discussed our report with Options and DPSS on March 29, 2013. Options' attached response indicates disagreement with our finding. DPSS will work with Options to ensure that our recommendation is implemented.

We thank Options management for their cooperation and assistance during our review. Please call me if you have any questions, or your staff may contact Don Chadwick at (213) 253-0301.

WLW:AB:DC:AA

Attachment

c: William T Fujioka, Chief Executive Officer
Sheryl L. Spiller, Director, Department of Public Social Services
Pat Huffman, Board Chairperson, Options
Cliff Marcussen, Chief Executive Officer, Options
Public Information Office
Audit Committee

**OPTIONS – A CHILD CARE AND HUMAN SERVICES AGENCY
CALWORKS STAGE ONE CHILD CARE SERVICES PROGRAM
FISCAL YEAR 2011-12**

ELIGIBILITY

Objective

Determine whether Options – A Child Care and Human Services Agency (Options or Agency) provided services to individuals who met the CalWORKs Stage One Child Care Services (Stage One) Program eligibility requirements.

Verification

We reviewed the case files for 23 (5%) of the 428 participants who received services during June 2012 for documentation to confirm their eligibility for Stage One Program services.

Results

Options had documentation to support all 23 participants' eligibility for Stage One Program services.

Recommendation

None.

PROGRAM SERVICES

Objective

Determine whether Options provided the services required by their County contract and Stage One Program guidelines, and whether the Program participants and child care providers received the billed services.

Verification

We visited Options' service site and reviewed the case files for 23 (5%) of the 428 participants who received services, and 23 (7%) of the 334 child care providers who provided child care during June 2012.

Results

Options provided services in accordance with the County contract.

Recommendation

None.

STAFFING QUALIFICATIONS

Objective

Determine whether Options' staff had the qualifications required by their County contract.

Verification

We reviewed the personnel files for eight (21%) of the 39 Options employees who worked on the Stage One Program.

Results

Options' staff had the required qualifications.

Recommendation

None.

CASH/REVENUE

Objective

Determine whether Options recorded revenue in the Agency's financial records properly, deposited cash receipts into their bank accounts timely, and that bank account reconciliations were reviewed and approved by Agency management.

Verification

We interviewed Options management, and reviewed the Agency's financial records and June 2012 bank reconciliations.

Results

Options recorded revenue in their financial records properly, deposited Department of Public Social Services (DPSS) payments into the Agency's bank account timely, and prepared monthly bank reconciliations appropriately.

Recommendation

None.

UNSPENT REVENUE

DPSS compensates Options on a fixed-fee basis for operating costs and the Agency's accounting records indicated that the Agency did not have any unspent revenue for Fiscal Year (FY) 2011-12. We noted Options' Stage One contract for FY 2011-12 did not require the Agency to return or reinvest unspent revenues. These provisions are necessary to ensure Program funds are spent for their intended purpose. Effective July 1, 2012, DPSS amended their Stage One contracts to require agencies to return or reinvest unspent revenues.

Recommendation

None.

EXPENDITURES/PROCUREMENT**Objective**

Determine whether expenditures charged to DPSS were allowable under the County contract, properly documented, and accurately billed.

Verification

We interviewed Options' personnel, and reviewed financial records for non-payroll expenditures totaling \$52,042 that the Agency charged to DPSS during October 2011 through June 2012.

Results

Options inappropriately recorded \$43,888 (84%) of the \$52,042 in non-payroll expenditures we reviewed to the Stage One Program. Specifically, the Agency inappropriately used estimates to allocate \$32,450 in shared program expenditures to the Stage One Program. The Office of Management and Budget's Circular A-122 – Cost Principles for Non-Profit Organizations does not permit the use of estimates to allocate shared program expenditures.

In addition, Options recorded \$11,438 in legal fees for contract negotiations, which is not an allowable program expense to the Stage One Program. At the time of our review, the Agency's contract did not allow the County to recover costs inappropriately charged to the Program. However, effective July 1, 2012, DPSS amended their Stage One contracts to allow the County to recover costs that are inappropriately charged to the Program.

Recommendation

1. **Options management ensure that all expenditures billed to the Stage One Program are allowable, properly documented, and allocated using allowable methods.**

FIXED ASSETS AND EQUIPMENT

Objective

Determine whether Options' fixed assets and equipment purchased with Stage One funds were used for the Program, and were adequately safeguarded.

Verification

We interviewed Agency personnel, and reviewed the Agency's fixed assets and equipment inventory list. We also performed a physical inventory of four items purchased with Stage One funds in prior years to verify the items exist and were being used as required.

Results

The items purchased with Stage One funds were used for the Program, and were adequately safeguarded.

Recommendation

None.

PAYROLL AND PERSONNEL

Objective

Determine whether Options charged payroll costs to the Stage One Program appropriately, and maintained personnel files as required.

Verification

We traced the payroll costs for eight employees, totaling \$12,354, for May 2012 to the Agency's payroll records and time reports. We also interviewed staff, and reviewed personnel files for eight Options Stage One Program staff.

Results

Options maintained personnel files for the eight employees reviewed. However, Options did not appropriately record payroll costs to the Program for six (75%) of the

eight employees. Specifically, Options allocated the payroll costs for the six employees based on time estimates rather than actual hours the employees worked on the Program. The inappropriately allocated payroll costs totaled \$7,728. However, as previously mentioned, Options' contract did not permit DPSS to recover the inappropriately allocated costs.

Recommendation

Refer to Recommendation 1.

COST ALLOCATION PLAN**Objective**

Determine whether Options prepared their Cost Allocation Plan (Plan) in compliance with their County contract, and used to allocate shared costs appropriately.

Verification

We reviewed Options' Plan, and a sample of expenditures from October 2011 through June 2012.

Results

Options' Plan was prepared in compliance with the County contract. However, Options did not comply with their Plan, and as previously mentioned, they used unallowable methods to allocate shared costs to the Stage One Program.

Recommendation

Refer to Recommendation 1.



PTIONS – A Child Care and Human Services Agency

Board of Directors

Patricia Huffman
Maxine T. Coleman
Veronica Galarneau
Howard Friedman
Susan M. Keith
David M. Wilbur
Ivy Lawhead

April 4, 2013

Wendy L. Watanabe, Auditor-Controller
County of Los Angeles
Department of Auditor-Controller
Countywide Contract Monitoring Division
350 South Figueroa Street, 8th Floor
Los Angeles, CA 90071

Executive Director/CEO

Cliff C. Marcussen

RE: Response and Plan of Correction to the Options – A Child Care and Human Services Agency CalWORKs Stage One Child Care Services Program Contract Compliance Review Fiscal Year 2011-12

Deputy Executive Director/COO

Dolores Meade

Dear Auditor-Controller Watanabe:

Chief Financial Officer

Amy H. Nih

**Deputy Executive Director/
Child Care Services Director**

Kelly O'Connell

Options appreciates the professional work of your staff in the process of reviewing and finalization of this audit, including the preliminary audit conference, the opportunity to present additional information and resolve some possible issues, the final exit conference and the opportunity for Options to present this response and have it published with the audit.

Facilities Director

Nat Sotelo

All three findings (except for the legal fees finding) essentially relate to one issue – that Options did not use cost allocation methodologies that comply with the requirements of federal OMB Circular A-122, which is the standard that Auditor-Controller staff used to determine if allocation methods were appropriate. For brevity, Options will respond once to this issue for all three findings. It is important to respond separately regarding these findings and the new (replacement) Stage One contract starting July 1, 2012, which is referenced in the audit, and for the 2011-12 period actually audited.

Head Start Director

Cherry Martinez Gan

State Preschool Director

Deborah Slobojan

Response re. New Stage One Contract effective July 1, 2012: Options recognized and agrees that reimbursement from the Los Angeles County Department of Public Social Services (DPSS) is this new contract is limited, in part, based on expenses; and therefore allocation methodologies that comply with OMB Circular A-122 (Part 230) are required by the new contract. Options had already taken steps to implement revised allocation methodologies to comply with OMB Circular A-122. We believe that the major value in the audit is forward looking to this new contract.

Surround Care Director

Rosemary Olachea-Heaslip

Options has separately discussed specific allocation methodologies with your staff during the preliminary and final exit conferences, and communicated to them in writing a list of various methodologies, which may be applicable to different staff positions or non-personnel expenses, and which Options believes comply with OMB Circular A-122. It is our understanding that your staff have agreed that these methodologies are appropriate (although Options acknowledges that Options has the responsibility to apply to each situation a methodology that is appropriate

Child Development Centers Director

Denise Fernandez

Enrichment Program Director

Robyn McLymont

Early Head Start Director

Sandra Maldonado

to that situation). If your staff disagrees with any of the methodologies provided in writing, we request that your staff discuss those concerns with Options.

Response re. 2011-12 Contract: Options disagrees with the finding that the allocation methodologies used, including estimated time allocations, were inappropriate. OMB Circular A-122 cost allocation rules apply to government grants and contracts where reimbursement to the contractor is, at least in part, based on expenses. OMB Circular A-122 says, in part: "These principles shall be used by all Federal agencies in determining the costs of work performed by non-profit organizations under grants, cooperative agreements, cost reimbursement contracts, and other contracts in which costs are used in pricing, administration, or settlement" [2 CFR 230, section 230.20 (a)]. The 2011-12 Stage One contract was a pure fee-for-service contract, and not a cost reimbursement contract (except for the very minor Outreach portion of the contract, where Options did utilize OMB Circular A-122 cost allocation principles). OMB Circular A-122 cost allocation principles simply do not apply to pure fee for service contracts, where cost is not a factor in the payments owed to Options. Therefore Options was free to utilize the most efficient cost allocation methodology that it wished to use, which was Options' practice under the 2011-12 contract. The fact that the 2011-12 contract did not have a provision for return of costs that were not allocated "appropriately" was, in fact, recognition that federal cost allocation rules were not applicable to this contract. In addition, it is important to note that the fee for service nature of this contract was an intentional policy of the Board of Supervisors itself, and not an oversight or mistake.

Response re. legal fees: Options disagrees with the finding and believes that the legal fees charged to the program did benefit the program. We would agree that it is debatable whether the primary benefit was to the 2011-12 contract or the new Stage One contract, but the fees were incurred during active work with the DPSS and were highly beneficial to DPSS, the County and all of the Stage One contractors. Nevertheless, Options understands the nature of the objection raised by the Auditor-Controller, and Options will not incur legal fees for this type of benefit in the new Stage One contract. Options understands that the Auditor-Controller is not objecting to all legal fees, and that legal fees for other situations (e.g., a dispute with a child care provider or an employee doing Stage One work) would be viewed as appropriate by your staff.

Options values the opportunity to serve county residents and participants in CalWORKs Stage 1 in collaboration with the County of Los Angeles, and believes that the participants receive huge benefits, and effectively move towards county identified goals, as a result of this collaboration. We value this audit in helping to clarify the cost allocation rules that are applicable to the new Stage One contract.

Sincerely,



Cliff Marcussen,
Executive Director

cc. Amy Nih, CFO, Options
Kelly O'Connell, Deputy Executive Director, Options